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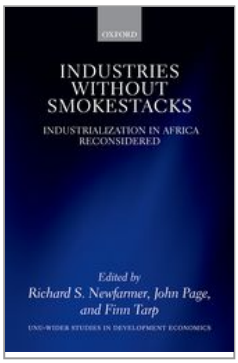

Industries without Smokestacks: Industrialization in Africa Reconsidered
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Abstract and Keywords

Structural change is taking place in Africa at a pace and with a pattern distinct from the historical experience of today’s industrialized countries. These differences reflect technological change, a changing global marketplace interacting with policy, a rapidly growing labour force and natural endowments. Some African countries, perhaps with coastal locations, will be able to transform their economic structures through manufacturing. However, it would be surprising if the successful African economy of the future closely followed the export-oriented manufacturing-led path that characterized East Asia’s structural transformation. Africa’s growing economies are likely to have economic structures that contain high value-added agriculture, agro-industry and tradable services in addition to a more robust manufacturing base. Global realities will force Africa’s policy makers to think of ways to promote structural transformation into activities beyond manufacturing.

Keywords: Africa, industrial transformation, technological change, structural transformation, policy makers, services, manufacturing

1. Introduction

While structural change is taking place in Africa, it is at a pace and with a pattern that is distinct from both the historical experience of today's industrialized countries and from more recent transformations in East Asia. These differences reflect the impact of technological change and a changing global marketplace interacting with policy, a rapidly growing labour force, and natural endowments. Some African countries—perhaps those favoured by coastal locations—will be able to transform their economic structures through manufacturing. The essays in this book also suggest quite strongly, however, that it would be surprising if the successful African economy of the future closely followed the export-oriented manufacturing-led path that has characterized East Asia's structural transformation. Africa's growing economies are likely to have economic structures that contain high value added agriculture, agro-industry, and tradable services in addition to a more robust manufacturing base. New global realities will force Africa's economic policy makers to think of ways to promote structural transformation into activities beyond manufacturing.

To transform their economies, African governments need to attract new firms able to compete in regional and global markets in services, tourism, and agro-industry in addition to other manufactures. At the same time they must boost the competitiveness of existing firms in these same sectors. While much of the effort to transform the region's economies will need to come from African governments themselves, the essays in Parts I and III of this book point to the crucial changes needed in global economic policy and in Africa's **(p.412)** regional economic communities (RECs). This chapter sets out new directions for public policy—at global, national, and regional levels—to widen the options for structural transformation.

2. Global Policy Reforms

The US retreat from leadership on multilateral issues, apparent since early 2017, has created a vacuum that, left unfilled, could impede progress on multilateral initiatives that would otherwise promote structural change in Africa. The WTO negotiations on trade in agricultural products, manufactures, and e-commerce in the Doha round were already moribund, foundering from complexity and multi-polar divisiveness. The new US administration immediately withdrew from negotiations on the Trans Pacific Partnership, a grouping of some twelve Pacific Rim countries. Meanwhile, across the Atlantic, the British vote to leave the European Union in June 2016 constituted another earthquake threatening a former pillar of multilateralism. For Africa, clearly, the first order of business is resisting the rising tide of protectionism.

2.1. Collective Action on Goods and Services Trade

The international community can assist African governments to defend the global trading system by more forthrightly addressing the uneven distribution of gains and losses through trade. A joint publication of the World Bank, IMF, and WTO undertaken for the G20 Sherpas meeting in March 2017 wrote: ‘ … recent experience shows that too many individuals and communities, notably also in the advanced economies, have been left behind by trade: there are legitimate reasons for discontent’.[1] The thrust of that report was a recommendation to strengthen the multilateral rules keeping markets open and to undertake serious country-based programs to mitigate trade adjustment costs. Of particular importance is portable access to health care, retirement programmes and education. It remains to be seen whether politicians and their societies in the OECD will adopt this view.

The current headwinds notwithstanding, several other global initiatives can support trade-led structural transformation. Reducing trade costs has an immediate and powerful effect on trade, and so one priority for multilateral collective action is to implement the Trade Facilitation Agreement (TFA) fully. Ministers were able to rescue the TFA at the Bali Ministerial in 2013, and it took effect in February 2017, when two-thirds of the WTO membership completed **(p. 413)** their individual ratification of the arrangement. The TFA includes largely voluntary provisions to expedite the movement, release, and clearance of goods, and protection of goods in transit. It also outlines ways for customs and other appropriate authorities to cooperate on trade facilitation and customs compliance, along with modalities for technical assistance and capacity building.

By reducing both the variable and fixed costs of exporting, trade facilitation increases the exports of those firms already involved in international trade, while enabling new firms to export for the first time. The WTO (2015) estimates that full implementation of the TFA could reduce trade costs by an average of 14.3 per cent, and that African countries may benefit from reductions in trade costs in excess of 16 per cent. Full implementation of the TFA can reduce time to import by over a day and a half (a 47 per cent reduction over the current average) and time to export by almost two days (a 91 per cent reduction over the current average). While these estimates are necessarily sensitive to assumptions and model structures, they do convey the importance of agreements to reduce trade costs.

Greater market access can also boost Africa's exports. Trade policy in Africa's main trading partners—especially those in Asia—has an important role to play in easing the entry of non-traditional African exports. Although Asia's tariffs on African exports are gradually declining, the trend is weak, especially for Africa's least developed countries. As Fukase and Martin argue in Chapter 5, an essential step is to reduce escalating tariffs directed at higher stage processing of commodity exports. These discourage the development of agro-industrial value chains. China could play a leading role here by shifting its preferential trading agreements with Africa from country by country bilateral deals to a single well publicized Africa-wide initiative. This might push its Asian trading partners to offer similar tariff reductions.

Unilateral preferential trade programmes such as the US Africa Growth and Opportunity Act (AGOA) and the EU's 'Everything But Arms' (EBA) programmes have contributed to an expansion of manufacturing and other exports from Africa. AGOA now covers forty countries, and nearly all of Africa's exports to the US. Launched in 2000, it was renewed in 2015 and now extends to 2025. The EBA also grants duty-free, quota-free access to the EU market. As a result, as Fukase and Martin point out, tariffs on Africa's exports to these major markets on average are less than 1 per cent, substantially less than in other markets. The only pall of uncertainty is the withdrawal of the UK from the EU—and with it prospectively the 17 per cent of the European market that it represents.

The Trade in Services Agreement (TISA), launched in 2012, may eventually have consequences for Africa. Negotiations are on-going and involve twenty-three negotiating parties, including the EU and US as well as a handful of developing countries (mainly from Latin America) and one African country, **(p.414)** Mauritius. The agreement would provide access to foreign services suppliers on the same terms as domestic suppliers in areas such as transport, health, and finance. Its short-run fate, however, may be similar to other multilateral accords. Domestic politics in the US and Europe appears to have stalled progress.

Support for open world trade may be shifting, but not solely toward protection. While the US did withdraw from the Trans-Pacific Partnership Agreement in early 2017, a year later in January 2018, the eleven remaining countries announced broad agreement on a new trade pact, christened the Comprehensive and Progressive Agreement for Trans-Pacific Partnership. Meanwhile, China, India, and Brazil have begun recently to play much more prominent roles in world trade talks, moving from participants in blocking coalitions, to new proponents of change. Perhaps reflecting its position as a capital exporting country, China has recently advocated a new 'investment facilitation agreement' that would cover foreign direct investment, and is pressing its ideas in the G20. India, a major exporter of services, tabled a paper on 'services facilitation' at the WTO in February 2017. While it is too soon to draw definitive conclusions, these actions may constitute the first steps toward a new multilateralism.

2.2. Development Assistance and Infrastructure Finance

In the past, Official Development Assistance (ODA) was a key element promoting structural transformation in Africa. Infrastructure, particularly electric power, roads, and railways, is essential to trade-led structural transformation, and financing from external sources has enabled much investment of this type. After a slow start, the aid-for-trade initiative of the WTO has contributed to mobilizing additional resources for trade-related infrastructure and trade-related economic activities (see Lammerson and Roberts 2015). These funds have mainly gone to countries that are trading less than key indicators would predict and have contributed to positive results in trade creation (Gamberoni and Newfarmer 2014).

In recent years, as finance through the concessional windows of the World Bank (the International Development Association, IDA) and other MDBs has become constrained, governments in Africa have mobilized new sources of finance, including private borrowing. Countries from Angola to Zambia have issued sovereign bonds. Borrowing on private markets has grown rapidly. Steady global market conditions and the potential for higher returns for investors have helped pave the way for more access to international markets, where the average return for these bonds is about 6.6 per cent, with an average maturity of ten years. Sovereign bonds and borrowings from commercial banks now amount to more than 40 per cent of outstanding public debt for Ghana, Senegal, and Zambia (Vellos 2016).

(p.415) Because sovereign borrowing can involve high costs and short maturities, a better alternative would be for the international community to allow creditworthy countries to borrow from the non-concessional windows of the World Bank and other multilateral development banks. Terms are far less onerous—typically less than 1 per cent over Libor compared to 5–7 per cent in private debt markets with longer grace and repayment periods, up to 15–17 years. Moreover, using blend financing—concessional and non-concessional loan packages—as well as guarantees of private lending to finance infrastructure would yield a higher social benefit-cost ratio than recourse to private markets alone (E15 2016). Greater cooperation and coordination between DAC donors and non-traditional donors, perhaps through the international financial institutions to which they both belong, could also improve the focus and efficiency of resource use.

3. Country-Level Strategy for Structural Transformation

The literature on industrialization in developing countries suggests that three factors have largely shaped the global distribution of smokestack industry by attracting new investment and raising the productivity of existing firms (UNIDO 2009; Newman et al. 2016). The first is conventionally termed the ‘investment climate’—the policy, institutional, and physical environment within which firms operate (Stern 2001, 2002). The second factor is exports. A third factor is agglomeration—manufacturing and services firms tend to concentrate geographically.

These determinants of locational choice are mutually reinforcing. Investments in infrastructure and skills raise the potential productivity of all firms, making some of them more likely to succeed in external markets. Industrial exports help to build firm capabilities which are then transferred through agglomeration. Agglomerations raise firm-level productivity. In poorer countries they also generate competitive pressures that reduce the incentives to cluster, unless the clusters are export-oriented. Thus, a strategy that encompasses each of these factors is critical to the success of any industrialization drive.

Because they share many firm characteristics with smokestack industries, the industries without smokestacks analysed in this book respond largely to the same drivers of locational choice. This makes it possible to sketch out a strategy for structural transformation that is broadly applicable to manufacturing, tradable services, agro-industry and horticulture. It is important to keep in mind, though, that each activity has unique characteristics. Generic, ‘one size fits all’ policy-making will be ineffective. Complementary sector specific public actions are also required.

(p.416) 3.1. The Investment Climate

The investment climate has come to be broadly and somewhat vaguely defined.[2] Here we focus on three areas that emerge from the essays in this volume as particularly relevant to industries without smokestacks—infrastructure, skills and competition. Reliable electrical power, lower costs of transport and workers better able to perform their jobs make countries more attractive to investors (IMF 2014). Promoting competition by reforming trade policy and domestic regulations can boost competitiveness.

Infrastructure

The productivity penalty that African firms pay as a result of poor infrastructure and skills has been extensively documented.[3] Sub-Saharan Africa lags at least 20 percentage points behind the average for low income countries on almost all major infrastructure measures. In addition, the quality of service is low, supplies are unreliable, and disruptions are frequent and unpredictable (Newman et. al 2016). By one estimate, the current infrastructure deficiencies in Africa contribute to a loss of about 2 percentage points per year in GDP growth.[4] Reliable electrical power may be the greatest single issue. The quality of electricity service is ranked as a major problem by more than half of the firms in more than half of the African countries in the World Bank's *Investment Climate Assessments*. Transport comes a close second to power across the region. Road infrastructure has received little attention, as until recently have the region's ports.

Not surprisingly, ICT-based services may be the most sensitive to infrastructure constraints. As Frishtak notes in Chapter 3, backbone infrastructure is essential to exploit opportunities in what he characterizes as first generation IT-enabled services. The cases of Kenya, Rwanda, and Senegal show that high speed data transmission is critical to exporting a wide range of services and especially to IT-intensive exports. Success depends on the ability to attract providers of cable and other links. Most African countries lack adequate backbone services because they went straight to mobile networks, without investing in connectivity first. Rwanda may be the exception; the government laid an internal backbone fibre optic cable throughout the country to connect virtually all regions.

A necessary condition for fully leveraging the tourism potential is to have adequate tourist-related infrastructure and high-quality services. Daly and Gereffi (see Chapter 4) point to the constraints to tourist development associated with air travel and road quality. Connectivity to the internet and communication infrastructure is also an important consideration for travellers **(p.417)** to Africa. Such logistical challenges restrict end-market upgrading opportunities. The country studies indicate that quality of infrastructure constrains Tanzania's and Uganda's ability to access luxury customers. In Rwanda, on the other hand, a drive from Kigali, to see the mountain gorillas in the Volcanoes National Park takes less than three hours on well-maintained highways. A recent spate of airport building, serves as a reminder that it is important to be rigorous in the evaluation of public investments targeted at the tourism sector. While terminal space can run out as traffic grows, and many countries aspire to develop passenger or logistics hubs, neither is a rationale for building a new airport. Bowfinger argues in Chapter 6 that there is no shortage of runways in Africa, given the current traffic levels. A properly run existing airport will often serve the business and tourism industry, and terminals can be developed with private sector participation.

Investments to improve trade logistics are essential to export success in agro-processing and horticulture. Fukuse and Martin note that the unbundling of global value chains is much more demanding of logistics than traditional approaches to the processing of agricultural commodities. Costs associated with customs clearance and domestic transport may make it uneconomic for firms to process agricultural goods. Vulnerability to excess costs is particularly acute for processing activities because these frequently operate on small margins relative to production of traditional exports such as coffee, which frequently embody a large share of rents. Horticultural exports are perishable and particularly vulnerable to delays in shipping. As Bofinger points out, the underlying infrastructure in getting cut flowers to the airport is critical to success. He notes that Kenya's flower-growing region is well connected by road to Kenya's international airport, whereas Ethiopia's flower-growing region in the past has had poor road connectivity to Bole International Airport in Addis Ababa, resulting in a 40 per cent spoilage rate.

Skills

Although Africans have more schooling today than in any previous generation, nearly 60 per cent of 15–24-year-olds have only completed primary school and only 19 per cent have gone beyond lower-secondary (Filmer and Fox 2014). Educational quality is an issue at all levels. Learning assessments in Africa show that most primary students lack basic proficiency in reading at the end of second or third grade. Employer surveys report that African tertiary graduates are weak in problem solving, business understanding, computer use, and communication skills.[5] Increasing access and improving the quality of education at all levels remain high priorities.

(p.418) The IT-enabled services industry is potentially constrained by its very source of competitive advantage. Both the Kenya and Senegal country studies identify the ability to hire university graduates at a fraction of the cost in Europe or the Arab Gulf as the initial impetus for IT-enabled startups. In Kenya attempts to expand the industry have rapidly encountered manpower constraints. Muchai and Kimuyu note in Chapter 11, for example, that an evaluation of IT skills in Kenya showed that there remains a substantial supply-demand gap in the high-end talent pool in the IT workforce. There is, in particular, a lack of software development and project management skills. They argue that this gap is particularly binding in mobile money, where collaboration between the private sector and institutions of learning is key to ensure the skills of graduates match the skills required to operate mobile money transfer services.

English notes in Chapter13 that Senegal ranks among the top fifty potential suppliers of outsourcing services according to the AT Kearney Global Services Location Index. However, it lies near the bottom—in forty-fifth place—and has fallen significantly in the last five years. The greatest weakness appears to be in the quality and quantity of human resources. English illustrates this in a case study of Senegal's Premium Contact Centre International (PCCI), a major call centre operator. In its early days, the company faced a severe skills shortage and labour turnover was high due to stiff competition for skilled workers. Today, the entry of the large French company, Atos, into Senegal is increasing the competition for IT engineers.

Hoekman argues in Chapter 8 that a workforce that has the skills needed to interact with tourists and to provide the many 'back office' services that are inputs into the production of high-quality tourism is essential to further development of the industry. Lack of skills consistently emerges from the country studies as a constraint to higher quality tourism. Daly and Gereffi note in Chapter 4 that management, organization, communication, and computer skills are critical for tourism distribution intermediaries and service providers seeking to upgrade their position in the tourism value chain. While there are international programmes designed to teach these skills, Africa only has two schools that have earned certification from the UN World Tourism Organization's Tedqual Programme.

Competition

Chapters 15 and 17 by Ellis, McMillan, and Silver, and Spray and Wolf, respectively, document large differences in productivity across firms in services and agro-industry.[6] Similarly, Ggombe and Newfarmer calculate that many services sectors have productivity levels several multiples of agriculture—and often **(p.419)** higher than manufacturing. Because productivity in services has an important impact on productivity levels across the economy, encouraging an environment where firms are compelled to search out productivity improvements is essential. This is where competition becomes important. It affects productivity through the exit of less efficient firms and the entry or expansion of their more efficient counterparts (Syverson 2011).

Lack of competition in transportation markets, emphasized by de Melo et al. in Chapter 19 and Karingi et al. in Chapter 18, represents a significant barrier to integrating markets within countries and in regional groupings. Atkin and Donaldson (2015) show that within countries the farther a product travels from its source, the higher the price. This is partly because of transport costs and partly because of regional monopolies in distribution. Raballand et al. show in Chapter 7 how lack of competition is associated with higher trucking costs and undermines competitiveness in the EAC. Bofinger argues in Chapter 6 that the great majority of air transport routes in Africa are near monopolies. In East Africa, many services markets, notably telecommunications and finance, are tight oligopolies dominated by a handful of firms.

Daly and Gereffi point in Chapter 4 to an important anti-competitive aspect of the structure of Africa's tourism industry. The 'Package Booking' distribution channel is particularly prominent in Africa, with foreign visitors often accessing safari, eco-tourism, and surf and sand products through entrenched networks of actors that have strong ties to one another. Lead firms assemble and package individual services into cohesive travel experiences. Low domestic demand for African tourism strengthens the position of these global lead firms because the entry of local tour operators is constrained by low levels of domestic demand for tourism. Notably, the country studies reveal that few governments have strategies designed to promote tourism at either the regional or national level.

These issues underscore the importance of competition policy in several dimensions. First, import competition—including from within regional economic communities—is extremely important to discipline local manufacturers and service providers in their pricing, investment and technology decisions. Second, removing barriers to foreign entry can increase competition, reduce costs and extend access to a broader range of differentiated services. Hoekman argues in Chapter 8 that FDI is a particularly important channel for the transfer of know-how and technology, as foreign firms introduce new types of services that may be better suited to the needs of clients. Boefinger notes that reducing barriers to airline entry by adopting 'Fifth freedom rights' can pave the way for eventual competition. Third, although African countries have experienced an increase in competition for the provision of telecom services, efficient regulation remains important where a single dominant firm—as in the telecoms sector in Ethiopia or Senegal—effectively **(p.420)** controls the price level. Finally, because it is likely that many companies in Africa will enjoy a degree of market power for some time, it is imperative that tax and investment policies encourage private investment so that any monopoly rents are reinvested in expanded production.

3.2. Tilting Towards Exports

For most countries in Africa, the regional and global export market represents the best option for rapid growth of horticulture, agro-industry, and tradable services. Exports permit firms to realize economies of scale and in low-income countries the act of exporting raises firm productivity through learning (Harrison and Rodriguez-Clare 2010). Because individual firms face high fixed costs of entering export markets, there is a risk that countries will export too little unless public policies are put in place to offset the costs to first movers. To deal with these externalities, African governments need to develop a consistent package of trade and exchange rate policies, public investments, regulatory reforms, and institutional changes to increase the share of non-traditional exports in GDP.

The structure of protection and the exchange rate have an important role to play in ensuring that exporting is as attractive as producing for the local market. For this reason, proper measurement of these incentives is essential. Tariffs may steer investment toward production for the domestic market, and tariffs on intermediates and capital goods can place exporters at a disadvantage relative to global competitors. Fukase and Martin even suggest that high tariffs and other charges on intermediate inputs result in negative value added at market prices in some agro-processing activities, giving one possible explanation for the region's lagging performance in this sector. One option to address any anti-export bias, is to create an effective 'free trade regime for exporters' through various mechanisms to eliminate or rebate tariffs on intermediate and capital inputs used in export production. While duty drawback, tariff exemption and VAT reimbursement schemes exist in many African countries, they are often complex and poorly administered, resulting in substantial delays. Export procedures—including certificates of origin, quality and sanitary certification and permits—can be burdensome.[7] One approach that has succeeded elsewhere is to streamline the trade regime first in special economic zones.

The exchange rate is arguably the most important price in the economy. It influences the relative attractiveness of producing for the domestic or foreign market. A competitive real exchange rate has underpinned most prolonged **(p. 421)** episodes of rapid export growth, whether in Chile or China (Hausmann et al. 2004), and Rodrik (2008a), among others, has argued for countries at early stages of structural transformation to attempt to undervalue the exchange rate over the medium to long term. Maintaining an undervalued exchange rate is difficult (and costly) in countries with small bond markets and large capital inflows, including aid. At a minimum, macroeconomic policy should strive to avoid overvaluations that stifle non-traditional exports over time.[8]

Trade in tasks has greatly increased the importance of trade logistics. According to WTO estimates, trade costs in developing countries are equivalent to applying a 219 per cent ad valorem tariff on international trade (WTO 2015). For this reason, investments in infrastructure and institutional reforms to improve trade logistics are essential to export success. Limao and Venables (2001), for example, find that an improvement in communication and transport infrastructure from the median score on the World Bank trade logistics index survey to the highest 25th percentile is associated with a decrease in transport costs of 12 per cent and an increase in trade volumes of 28 per cent. One study of port efficiency in APEC found that bringing below-average countries up to the APEC average level of port efficiency would produce US$117 billion in additional trade within APEC alone (Wilson, Mann, and Otsuki 2005).

Market structure and inappropriate regulations can also impede exports. Senegal provides an example of the costs to IT-based services providers of a monopoly controlling the price and quality of access to the backbone infrastructure. The high cost and limited flexibility of air transport constrains both horticulture and tourism. The aviation industry is heavily protected, with a plethora of small and uneconomic national airlines. As Bofinger points out, Africa is under-served by major airlines. Senegal has relied on scheduled flights for tourism, and with limited airline competition in its main French market, costs have been high. High costs of air transportation have prevented Mozambique and Tanzania from competing in the regional tourism market. While adopting an open skies policy might endanger some national airlines, it would introduce greater competition and reduce the cost of air freight through the development of competing, specialized, charter airfreight companies.

3.3. Spatial Policies

The studies of agro-processing, horticulture, and ICT-based services in this volume offer evidence that, like manufacturing, they benefit from agglomeration, **(p.422)** including thick labour markets, information and knowledge spill overs, and the ability to share overhead expenses and services. Geography also plays an obvious role in tourism: tourist facilities tend to cluster close to the tourism resource. Agglomerations pose a collective action problem: if a new location can attract a critical mass of firms, each firm will realize productivity gains from clustering. Yet, until the location reaches critical mass, there is no incentive for individual firms to move.

Governments can foster agglomerations by concentrating investments in high-quality institutions, social services, and infrastructure in a limited area, such as a special economic zone (SEZ) or an industrial park (UNIDO 2009; Farole 2011). While most first-generation SEZs have been focused on manufacturing, they are relevant to services and agro-based industries as well. Services export companies look for customized facilities such as IT parks with modern office space, high-speed broadband links, reliable power supply and ancillary infrastructure. The Software Technology Parks of India Initiative (STPI), launched by the Indian government to attract potential IT investors, proved essential to the growth of the software industry (Dongier and Sudan 2009). In agro-industry and horticulture, Indonesia and the Philippines have established agro-industrial SEZs, near growing areas to promote processed agricultural exports.

Most African countries are relative latecomers to the promotion of SEZs. Many SEZ programmes began only in the late 1990s or early 2000s. Globally, SEZs rarely experience rapid growth in their first 5–10 years of operation, and it may be too early to judge their success in Africa. In any case, evidence suggests that, in many countries—such as Malawi, Mali, Nigeria, Senegal, and Tanzania—zones are struggling (Newman and Page 2017). One reason for the lack of dynamism is that most African SEZs have failed to reach the levels of infrastructure and institutional performance needed to attract global investors.

A number of countries such as Ethiopia, Ghana, Nigeria, and Tanzania are giving SEZs another go. Most of these countries have zones that include agriculture-related sectors such as agri-business, agro-processing, livestock, and dairy products. Zones focused on high-end service sectors are less common. Some examples include the East London IDZ in South Africa and ITC and Biotechnology focused zones in Benin and Cote d’Ivoire (Newman and Page 2017). A critical challenge will be to bring the physical, institutional and management quality of these zones up to a level that is sufficiently attractive to investors with global alternatives. In Rwanda, for example, Steenbergen and Javorcik (2017) have shown that firms in the SEZ in Kigali are substantially more productive, in part because the government offered business facilitating services, including more efficient import procedures.

Spatial policies can be used to encourage the formation of value chain relationships. Daly and Gereffi note in Chapter 4 that underdeveloped **(p.423)** linkages between tourism and sectors such as agriculture and construction can inhibit industry development and limit the economic benefits associated with tourism. Where foreign tour operators, hotel companies, and investors control supply chain decisions and procurement opportunities, linkages between tourism and domestic supporting industries often remain underdeveloped. In Senegal, English reports that a 2003 study estimated the import content of tourism spending at 30 per cent. The Tanzania country study suggests that almost 30 per cent of tourist spending leaks into foreign markets, through consumption of imported goods or services.

South Africa is attempting to use spatial policies to increase local participation in the tourism value chain. Its Department of Environmental Affairs and Tourism sets guidelines for responsible sourcing—purchases that are made from businesses within 50 kilometres. Daly and Gereffi argue that while adherence to the targets has been uneven, the initiative provides a basis to address the poor communication and mistrust that sometimes characterize food-supply value chain relationships. They also suggest that national or regional investment departments can create databases of qualified construction contractors, sub-contractors, and suppliers that investors can access before projects commence.

3.4. The Role of Industrial Policy

Many of the conventional public actions outlined above—the structure of protection, exchange rate policies, investments in trade facilitation, and reform of regulations—fall under the rubric of industrial policy. That is, policies designed to promote selected industries or activities. Perhaps no other term in economics has generated more heat with less light. Fortunately, industrial policy is finally moving away from the fruitless debates on ‘picking winners’ versus ‘levelling the playing field’ towards the policy mainstream. There is broader agreement that information, learning, and geography combine to make a strong case for industrial policy (Stiglitz 1996, 2001; Rodrik 2008b). Arkebe Oqubay in a sophisticated discussion of Ethiopia’s industrial policy argues that ‘the state in Africa must play an activist and developmental role beyond being merely a “facilitating actor”; that is, being little more than a servant of comparative advantage’.[9] The lesson he derives is that policy has to be strategically driven and consistent, a proposition reflected in the strategy set out above.

(p.424) Today many countries are integrating industrial development strategies that use various policy instruments into major development efforts.[10] Rodrik (2004) lays out ten principles of an industrial policy for the twenty-first century. These include: (a) target only new activities, not sectors, and only those with clear potential for spillovers; (b) build in sunset clauses and feedback loops so mistakes can get corrected; (c) establish clear benchmarks of success; and (d) ensure that implementing agencies are competent and can be held accountable. It is important to note that few governments actually adhere to these principles.[11]

For this reason, while a strategy is essential, governments could raise the probability of successful results by adopting five best practices. The first is to avoid adopting policies that protect incumbents and restrict competition. In the EAC, for example, several governments are considering adopting performance requirements, market reservations and preferences for domestic firms in government procurement, among other policies, including export and import bans. Competition from imports is an important driver of productivity growth (Newfarmer and Sztajerowska 2012); competition from new entry in services markets can drive down prices and improve services (Hoekman and Mattoo 2008); intra-industry competition within regions can help create larger firms and, by driving out marginal uncompetitive firms, raise industrial productivity throughout the region. Second, transparency in granting direct and indirect subsidies is essential to ensuring that they can be curtailed if ineffective or phased out when no longer needed. One option, following the New Zealand practice, is to report tax and other incentives as ‘tax expenditures’ or fiscal outlays that could be reviewed annually as part of the budget process. Third, an important, and often overlooked, practice is to ensure that the performance of firms receiving tax breaks in exchange for particular commitments, such as to invest or export certain amounts, is monitored adequately to ensure they actually fulfil their promises. Fourth, programmes designed to promote selected activities should incorporate periodic reviews and be evaluated against projected achievements. Requiring that an incentive expire unless a review recommends that it be extended places the burden on advocates to show why it remains relevant. Finally, at the outset of devising a national strategy, it is helpful to begin by analysing the cumulative effects on resource allocation of existing industrial policies. All governments have industrial policies, so undertaking a comprehensive review can surface activities that may be underserved and ones that perhaps are receiving too much public support.

(p.425) 4. The Role of Regional Agreements

The small size of Africa’s economies and the fact that many are landlocked make regional approaches to infrastructure, customs administration, and regulation of transport in trade corridors imperative. Moreover, neighbouring markets can provide the needed access and preference margins to jumpstart a wide variety of exports; and in an era of value chains, they offer the opportunity to develop local value chains that could be a spring board to the global market.

4.1. Uneven Progress Toward Deeper Integration

Ever since the Abuja Treaty was signed in 1991, African governments have looked to regional economic integration to expand intra-African trade, to harmonize regulations and policies, to establish coordinated monetary policies, and even to achieve political union. As de Melo et al. point out in Chapter 19, these goals have proven elusive. They find that reductions in tariffs and non-tariff barriers have been implemented only slowly, that other aspects of policy and regulatory harmonization have lagged and that efforts to integrate in services trade have by and large been ignored. Growth in regional trade has barely kept up with exports to the rest of the world, and the introduction of new products in the RECs, a key indicator of export dynamism, has only accounted for a small percentage of trade growth.

They argue that one reason for the minimal impact of these agreements is that even when ambitious regulatory reform measures are enacted, they lack enforcement. Trade costs have come down relative to pre-agreement levels, but more for agriculture than for manufactures—and in only a few of the RECs. De Melo and his colleagues suggest that the key to unlocking more vigorous regional trade is to abandon the old approach of negotiating over increasing market access in the context of an effort to build vertically integrated regional value chains and instead focus on reducing trade costs and liberalizing services markets in order to develop horizontally organized production chains.

In Chapter 18, Karingi and others give a somewhat more upbeat interpretation of the effects of integration in the East African Community. They find that the combined share of EAC members’ intra-regional exports remained about the same (at 18 per cent) before and after the community was launched. That said, some countries gained market share—notably Uganda and, to a lesser extent, Burundi and Tanzania—and, together with Kenya, have benefitted from substantially more exports to other countries in Africa. In fact, for the EAC as a whole, exports to Africa outside the EAC amount to about the same share of exports as intra-EAC exports.

(p.426) Karingi et al. argue that the EAC has been a springboard for manufactured-, services-, and agro- exports to other parts of Africa. They note that intra-EAC exports are much more diversified than the community's global exports. Manufactures, for example, comprise 55 per cent of intra-EAC exports and only 19 per cent of exports to the rest of the world. Moreover, exports of EAC countries to other African countries mirror the intra-EAC pattern of greater diversification with over half of the exports in manufactures. The authors showcase the dairy industry as an example where intra-EAC exports from Uganda have flourished—albeit behind a common external tariff of 60 per cent on imports.

4.2. The Way Forward: Regional Initiatives Promoting Transformation

Using the regional economic communities to propel trade integration and the development of regional value chains can occur through three main channels: reforming price incentives, strengthening trade facilitation and services regulation, and investing in interconnected physical infrastructure.

Reforming Price Incentives

Price incentives in Africa, despite the complex system of regional preferences, still tend to discourage production for the external market and inhibit the emergence of regional and global value chains. Karingi and his colleagues observe that tariffs facing exports to the rest of Africa from the EAC are substantially higher than to other regions and much higher than to high-income regions. Fukase and Martin suggest that average protection against African exports is 1.7 per cent in the rest of the world compared to 6.1 per cent within Africa itself. Tariff escalation in agriculture is particularly notable within Africa. Processed agricultural products are taxed on entry to other African markets at a rate nearly four times higher than bulk agricultural exports. Progress toward the Africa-wide Continental Free Trade Area, as de Melo and his colleagues note, could help reduce these distortions.

Regional forums and agreements can help curtail the adoption of 'beggar thy neighbour' policies that are emerging in many countries. Fiscal incentives are becoming an increasingly popular export promotion instrument among African governments. According to new data assembled by the World Bank, sub-Saharan Africa enacted more tax incentives to attract firms—typically multinational companies—to invest in export-oriented production than any other region between 2009 and 2015. These included tax holidays and preferential tax rates. Because competition among governments in granting tax incentives is intense, the marginal effect from an aggregate African perspective may be lost tax revenue with little benefit in export expansion (Von Euxkull et al. 2017).

(p.427) Trade Facilitation and Services Regulation

As noted above, regional institutions have already made significant progress in reducing trade costs. Although de Melo and others only partially attribute these declines to the regional agreements per se, there is little doubt that increased coordination has played a role. Trade costs are falling sharply—and in the EAC the results in terms of expanded firm level exports have been tangible (see Spray 2017; Karingi et al. in Chapter 18). In addition, the regional agreements have facilitated rapid growth in the export of transport services. Within the EAC transport services can amount to a sizable portion of services export earnings. In Uganda for example, transport services have averaged nearly 10 per cent of services exports in the period 2014–15 (Shepherd 2016). In Rwanda, transport earnings were 11 per cent of services exports in 2016 (Ggombe and Newfarmer).

Services regulation is the area where regional institutions have done the least and where the gains are possibly the highest. In the EAC, efforts in telecoms deregulation have integrated markets in long-distance services. The virtual elimination of roaming charges through collective regulatory action by the Northern Corridor countries (Rwanda, Uganda, and Kenya) has lowered prices, expanded consumer volume, and at the same time increased firm profitability.[12] Similarly, introducing a joint visa programme in the Northern Corridor countries has facilitated tourist travel among the three participating countries. Replicating these initiatives in finance, mobile money, education, and professional services, as well as in labour mobility generally would go far toward unleashing the potential for regional integration.

Investing in Interconnected Infrastructure

While interconnection of physical infrastructure is underway it could be accelerated. The Eastern Africa Submarine Cable System has installed some 10,000 kilometres of fibre optic cable that links most of Eastern Africa, including the landlocked countries to the global internet. This effort involved the coordination of various governments and their telecom regulators, and its completion offers new access at low cost for millions of East Africans. As both Frischtak and Murray note in their Chapters, access to low cost, fast internet can be transformative.

The development of IT infrastructure may bode well for interconnecting the power grid, where new installations can lower the cost of power from the current very high rates and improve reliability. The problems associating with power, however, are substantially more complex than for telecommunications. Road interconnections may be easier. In 2012, African ministers of transportation adopted a region-wide plan that included network routes, **(p. 428)** design standards and harmonization of safety, social, and environmental norms. These should facilitate completion of the gaps in the Trans-African Highway. Similar efforts are underway in rail and air transportation (UNECA 2013). The EAC's Northern Corridor has been coordinating on a standard gauge railway project (US$13.5 billion) and a single airspace arrangement (*All Africa News 2015*).

5. Conclusions

The research in this book gives some good news for Africa. Structural transformation is taking place. In contrast to traditional historical patterns—and in sharp contrast to East Asia—though, the movement of labour has gone less into manufacturing than into services. In some countries, industries without smokestacks—agro-processing and horticulture, tourism, and business and trading services—have provided a substantial portion of new high-productivity jobs. At the same time, the region's structure of trade is also changing. Although many countries still depend on commodity exports, Africa's export portfolio has become more diversified and less concentrated than it was two decades ago. As a result, the region is less vulnerable to the sharp swings in commodity prices than at any time in its post-colonial history.

The news is not all good, however. Africa faces challenges that differ from other region's historical experiences. One set of challenges is demographic. Rapid population growth interacting with extremely low productivity in traditional agriculture has led to a wave of urbanization at unprecedentedly low levels of average per capita income. This necessarily implies that high productivity jobs will be accompanied by low-productivity jobs, and the dispersion of productivity in cities will be large. It also means that governments have to pay as much attention to increasing within-sector productivity as reallocating labour into new sectors (Jones and Tarp 2017). Another challenge will be the changing global outlook and a possible retreat from multilateralism in rich countries. While recent forecasts point to stronger world economic growth than in most of the post-Great Recession period, political developments portend at least a pause in the trend toward greater openness and in the evolution of the rule-based system that provided a favourable climate for East Asia's rapid development.

We began this chapter by asserting that the successful African economy of the future will have to find its own path forward. It will, however, have transformed from a mainly agricultural economy into one characterized by a range of tradable, high value-added industries—with and without smokestacks. Policy changes at the global, national and regional level will be needed for that transformation to take place. If they can be achieved, Africa will have some new lions.

(p.429) References

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Notes:

([1]) See IMF, World Bank, and World Trade Organization (2017).

([2]) See Newman et al. (2016) for a discussion.

([3]) See for example Escribano, Guasch, and Pena (2010).

([4]) See NEPAD, AU, and AfDB (2011).

([5]) See World Bank (2007) and Filmer and Fox (2014).

([6]) These differences in labour productivity surely reflect major differences in products produced and capital intensity in addition to efficiency in production across firms.

([7]) See Clarke (2005); Yoshino (2008); Farole (2011).

([8]) See Eichengreen (2008).

([9]) Oqubay (2015: Chapter 1).

([10]) See, among others, ‘Kenya’s Industrial Transformation Programme’ (July 2015); ‘Made in Rwanda’ (draft January 2017); ‘Buy Uganda, Build Uganda’ (December 2016) and ‘Made in Sierra Leone’ (draft March 2017).

([11]) See Page and Tarp (2017).

([12]) See Karingi et al. in Chapter 18.